No. 16257

United States Court of Appeals
For the Ninth Circuit

United States of America, *Appellant,*

vs.

Frank N. Mattison and Ida C. Mattison, *Appellees*

On Appeal from Judgment of the United States District Court for the District of Idaho

BRIEF ON BEHALF OF APPELLEES

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UNITED STATES OF AMERICA, *Appellant,*

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ON APPEAL FROM JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF IDAHO

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INDEX

Page

I. Introduction 1

II. Question Presented 2

III. Statutes Involved 2

IV. Counter Statement of Fact 4

V. Argument 8

1. The Trial Court correctly applied to the facts the well established rules and precedents for determining the reporting of gains to stockholders from corporate liquidations 8
2. The cases cited in Appellant's Brief do not upon the facts of this case require that any exception be made to the established rules, statutes and regulations governing the taxation of gains from corporate liquidations 13
3. The finding of the Trial Court that Mattison in substance purchased the stock of the Westcott Oil Company and realized a profit in 1953 from its complete liquidation is essentially a finding of fact amply supported by the record 39
4. Without disregarding basic statutes and rules of taxation, application of the Kimbell-Diamond rule would not achieve a result different from that reached by the Trial Court 43

VI. Conclusion 51

CITATIONS

Cases

Ahles Realty Corp. v. Commissioner, 71 F.2d 150 16

Arrowsmith v. Commissioner, 344 U.S. 6 48

Brugh v. Commissioner, 32 B.T.A. 898 11

Case v. Commissioner, 103 F.2d 283 .... 9, 40, 49

Page

Commissioner v. Ashland Oil and Refining Co., 99 F.2d 588........13, 14, 16, 17, 18, 19, 20, 24, 27, 39
Commissioner v. Court Holding Co., 324 U.S. 331...... 39
Conte Equipment Corp. v. Commissioner, T.C.M. 1958 No. 171........ 36
Cullen v. Commissioner, 14 T.C. 368........13, 17, 22, 23
Dobson v. Commissioner, 320 U.S. 489........ 47
Dresser v. United States, 55 F.2d 499........ 11
Earle v. Commissioner, T.C.M. 1945 No. 281........ 11
Georgia-Pacific Corp. v. U. S., 264 F.2d 161........ 40
Graves v. Commissioner, T.C.M. 1952 No. 143..48, 49, 50
Guardian Investment Corp. v. Phinney, 253 F.2d 326 6
Harkness v. Commissioner, 31 B.T.A. 1100........ 11
Heiner v. Mellon, 304 U.S. 271........ 6
Heller v. Commissioner, 147 F.2d 376........ 39
Houck v. Hinds, 215 F.2d 673........ 39
Jacobs v. Commissioner, 224 F.2d 412........ 39
Kanawha Gas and Utilities Co. v. Commissioner, 19 T.C. 1023, Rev., 214 F.2d 685........13, 17, 27, 39
Kell v. Commissioner, 31 B.T.A. 212........ 11
Kimbell-Diamond Milling Co. v. Commissioner, 14 T.C. 74—Affirmed per Curiam 187 F.2d 718......13, 16, 17, 20, 24, 27, 32, 39
Kirby v. Commissioner, 35 B.T.A. 578........ 11
Kolkey v. Commissioner, 254 F.2d 51........ 39
Koppers Coal Co. v. Commissioner, 6 T.C. 1209..13, 17, 18
Letts v. Commissioner, 30 B.T.A. 800, Affirmed 84 F.2d 760........ 12
Ludorff v. Commissioner, 40 B.T.A. 32........ 12
Mackubin v. Commissioner, T.C.M. 1948 No. 072...... 41
Mather v. Commissioner, 149 F.2d 393........ 16

Page

Mattison v. United States, 163 F.Supp. 754 4
McCaughn v. Real Estate Title and Trust Co., 297 U.S. 606 40
Montana-Dakota Utilities Co. v. Commissioner, 25 T.C. 408 .... 13, 27
Northwest Bancorporation v. Commissioner, 88 F. 2d 293 11
Pittman v. Commissioner, 14 T.C. 449 48
Quinn v. Commissioner, 35 B.T.A. 412 12
Security Flour Mills Co. v. Commissioner, 321 U.S. 281 .... 46, 47
John Simmons Co. v. Commissioner, 25 T.C. 635 .. 17, 31
Smith v. Commissioner, 26 B.T.A. 1178 11
Snively v. Commissioner, 19 T.C. 850, Affirmed 219 F.2d 266 .... 13, 17, 24, 25, 26, 31, 47, 48, 49
Spirella Co. v. Commissioner, 155 F.2d 908 39
Sutliff v. Commissioner, 4 B.T.A. 1068 11
Trianon Hotel Co. v. Commissioner, 30 T.C. 156 .... 17, 33
Tulsa Tribune Co. v. Commissioner, 58 F.2d 937 16
United Mercantile Agencies v. Commissioner, 23 T.C. 1105 50
United States v. Cumberland Public Service Co., 338 U.S. 451 39
United States v. Lewis, 340 U.S. 590 47
Virginia-Lincoln Furniture Corp. v. Commissioner, 56 F.2d 1028 6
Westover v. Smith, 173 F.2d 90 12
Word Supply Co. v. Commissioner, 41 B.T.A. 965 12

Statutes

Internal Revenue Code of 1939
Sec. 41 (26 U.S.C., 1952 ed. Sec. 41) 2, 6, 48

Page

Sec. 42 (26 U.S.C., 1952 ed. Sec. 42) 6, 48
Sec. 115 (26 U.S.C., 1952 ed. Sec. 115) 2
Sec. 117 (26 U.S.C., 1952 ed. Sec. 117) 3

Internal Revenue Code of 1954
Sec. 334 (b)(2)(B) 18
Sec. 441 6
Sec. 451 (a) 8

Regulations

Sec. 39.41-1, Regulations 118, Promulgated by the Commissioner under the Internal Revenue Code of 1939 6
Sec. 39.42-1, Regulations 118, Promulgated by the Commissioner under the Internal Revenue Code of 1939 8
Sec. 39.115, Regulations 118, Promulgated by the Commissioner under the Internal Revenue Code of 1939 3

Miscellaneous:

General Counsel Memorandum Opinion, No. 14207; Cumulative Bulletin XIV-1, page 68 (1934) 11
Prentice-Hall—Federal Taxes, Sec. 9195 A 11
Commerce Clearing House, Inc., Standard Federal Tax Reporter Sec. 2403 12
Mertens, Law of Federal Income Taxation, Sec. 9.86 12

United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA, *Appellant,* vs. FRANK N. MATTISON and IDA C. MATTISON, *Appellees.*	No. 16257

ON APPEAL FROM JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF IDAHO

BRIEF ON BEHALF OF APPELLEES

I. INTRODUCTION

Frank N. Mattison and his wife, the appellees, have for many years reported their income and expenses for each calendar year on the cash basis. The transactions here in question are those of Frank N. Mattison. For convenience he will sometimes be referred to as "Mattison." Appellant will usually be referred to as "the Government."

In June of 1952 Mattison purchased the remainder of the outstanding stock of the Westcott Oil Company, a successful and sizeable corporation engaged in the business of distributing petroleum products, hereinafter sometimes referred to as "the Company," hoping to make a profit through its liquidation. Immediately, after acquiring this stock, he distributed the operating assets to himself, sold them, and, before the close of 1952 realized a gain of $23,267.29. This gain the Mattisons reported in their joint return for the calendar year

1952 partly as short term capital and partly as long term capital gain.

The Westcott Oil Company was a large and complex business. When its liquidation was completed the Company distributed to Mattison between May and November of 1953 the sum of $102,861.66. This final distribution less a small amount of expenses the Mattisons reported in their return for the calendar year 1953.

The Trial Court below found that this final distribution was taxable to the Mattisons in 1953, when received. From this result the Government has appealed, urging that these funds are taxable in 1952.

II. QUESTION PRESENTED

Whether the Trial Court erred in holding that the final distributions in liquidation of the Westcott Oil Company were taxable to Mattison in the year in which such distributions were made by the Company and received by Mattison.

III. STATUTES INVOLVED

Internal Revenue Code of 1939:

Sec. 41. *General Rule.*

"The net income shall be computed upon the basis of the taxpayers' annual accounting period (fiscal year or calendar year as the case may be) . . .

Sec. 42. *Periods in which item of gross income included.*

"(a) The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer . . ."

Sec. 115. *Distribution by corporations.*

"(c) *Distribution in liquidation.* Amounts dis-

tributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock."
Sec. 117. *Capital Gains and Losses.*

"(a) *Definitions*—As used in this chapter—

(4) (as amended by Sec. 150(a)(1) of the Revenue Act of 1942, c. 619, 56 Stat. 798) *Long-term capital gain.*—The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, . . ."

Section 39.115(c)-1 of Regulations 118 promulgated by the Commissioner under the Internal Revenue Code of 1939 provides in part:

"(a) Amounts distributed in complete liquidation of a corporation are to be treated as in part or full payment in exchange for the stock so cancelled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and § 39.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; . . .

"(b) The term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. . . .

* * *

"(d) For the purposes of the last sentence of section 115(c), a liquidation may be completed before the actual dissolution of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver or trustees

in liquidation are finally divested of all the property (both tangible and intangible)."

IV. COUNTER-STATEMENT OF FACTS

The facts are set forth in the findings of fact by the Trial Court (R. 31-45) and summarized in its published opinion[1] (R. 21-31). The chronology of events is accurately set forth in Appellant's brief (App. Br. p. 3 through 11). No need appears for extensive repetition.

The only substantial criticism of Appellant's statement of facts is that it fails to direct the Court's attention to the fact that Mattison made a bona fide purchase of stock (R. 44) and realized the profit here in question as a result of the successful liquidation of a highly complex business organization rather than from a sale of its physical properties (R. 43). Appellee's counter statement of fact will be limited to this area of difference.

The Westcott Oil Company had been in existence for over 30 years, engaged in the business of selling gasoline and related petroleum products in the states of Idaho and Oregon (R. 33). It was a very successful business venture, earning sizeable profits and paying dividends. Its name was well known (R. 33). Its operation extended over almost the entire state of Idaho and parts of Oregon (R. 90, 141). At the time Mattison acquired its stock its facilities consisted of 24 bulk plants (R. 90, 140), (40 filling stations (R. 140) and thousands of items of personal property (R. 141). The Company also had very substantial liabilities including a note in the amount of $310,123.89 to the First Security Bank of Idaho (R. 40). It filed income tax returns with the Unit-

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[1] *Mattison v. United States,* 163 F.Supp. 754.

ed States and two states and was liable for numerous other taxes, the amounts of which were uncertain (R. 91, 92, 135, 136).

Ike Westcott contacted several parties in an effort to sell the stock of the Westcott Oil Company (R. 34, 81, 82, 83). No negotiations by the selling stockholders were ever undertaken with Mattison or anyone else for a sale of assets (R. 34). The price which the selling stockholders demanded was an amount sufficient to net them $500.00 per share after taxes (R. 34). This price was not based upon an appraisal of assets but was simply a price the selling stockholders picked out of the air as the price they wanted for their shares (R. 35, 83, 84, 85, 86, 87, 112). There was no direct connection between this price and the value of the Company's physical properties (R. 35, 44). This price took into account the earning history of the Company, its going concern value, its good will and other factors (R. 44, 112, 113).

The selling stockholders testified they sold stock, not assets (R. 80, 87, 88, 89, 187, 214). Mattison testified he purchased stock, not assets (R. 126-129). All the formalities and legal requirements incident to a purchase of stock were complied with and all the instruments involved in the transaction contemplated a purchase of stock (R. 43). Mattison by the purchase of the outstanding stock of the Westcott Oil Company acquired not only the assets of the Company but also all its sizeable liabilities including a liability of $310,000.00 to the First Security Bank of Idaho, known and unknown liabilities for taxes, and liability for all future claims of every nature which might be made against the Company.

Mattison acquired the cash funds of the company, its accounts receivable, and its accounts payable. In short, Mattison acquired every right and liability and every advantage and disadvantage which goes with the usual purchase of stock. There were no side agreements between Mattison and the selling stockholders which would distinguish the transaction between them from an ordinary purchase of stock. Mattison, in short, purchased the stock of the Westcott Oil Company, not its assets (R.43). At the time Mattison purchased the outstanding stock of the Company and for some time thereafter there was considerable uncertainty as to whether final liquidation would be effected at a profit or at a loss (R. 85, 136). Corporate income tax returns for the year 1952 were not filed until March of 1953 (R. 143).

Mattison's purpose in acquiring the stock of Westcott Oil Company was not to acquire any specific physical assets but rather to liquidate the Company, he hoped at a profit (R. 21, 45). The winding up and liquidation of the Westcott Oil Company was accomplished as expeditiously as was reasonable in view of complexities involved (R. 43). Between May and November of 1953, as result of final liquidation, Mattison received a total of $102,861.66 (R. 41). The profit Mattison received in 1953 resulted from the complete liquidation of the Company over a period of time (R. 43).

There is no dispute between the parties as to the amount of Mattison's gain. The only dispute is as to the years in which it was received. The Trial Court found this gain was realized partly in 1952 and partly in 1953 as follows:

1952

Received in partial liquidation			
Physical assets having fair market value of		$1,689,399.07	
Less obligations assumed in the amount of		310,123.89	
Net receipts		$1,379,275.18	
Cost of shares surrendered			
25 shares acquired in 1945 at	$ 4,841.25		
2164 shares acquired in June 1952 at	1,347,480.57		
Total basis of shares		$1,352,321.82	
Gross profit		26,953.36	
Expenses incurred		3,677.07	
Taxable gain			$ 23,276.29

1953

Received in liquidation		
May 12, 1953	$ 101,585.76	
November 3, 1953	1,275.90	
Total received in final distributions	$ 102,861.66	
Cost of shares	0.00	
Gross profit	$ 102,861.66	
Expenses	38.17	
Taxable gain		$102,823.49
Total for both years		$126,099.78

V. ARGUMENT

1. The Trial Court correctly applied to the facts the well-established rules and precedents for determining the reporting of gains to stockholders from corporate liquidations

The Government brief overlooks some basic statutes and principles of taxation. The first such principle plainly set out in Sec. 41 of the Internal Revenue Code of 1939,[2] the Regulations of the Commissioner[3] and long recognized by the courts,[4] is that each twelve month tax period stands on its own basis unaffected (in the absence of specific provisions to the contrary) by what may or may not happen in following years. The second such basic principle is that income is taxable to a cash basis taxpayer in the year in which it is actually or constructively received.[5]

The problem of when in the light of these principles a gain or loss resulting from the liquidation of a corporation should be taken into account by the stockholders of such corporation for tax purposes has been considered many times by the Federal Courts and the Tax Court. One of the leading cases not only arose in this circuit but involves liquidation of an Idaho corporation. In

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[2] 26 U.S.C. 1952 ed. 41; Sec. 441, Internal Revenue Code of 1954.

[3] Sec. 39.41-1, Regulations 118, state in part: "Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year." See also Sec. 39.41-4 of Regulations 118.

[4] *Security Flour Mills v. Commissioner*, 321 U.S. 281 (1944); *Heiner v. Mellon*, 304 U.S. 271 (1938); *Guardian Investment Corp. v. Phinney*, 253 F.2d 326 (CA 5th 1958); *Virginia-Lincoln Furniture Corp. v. Commissioner*, 56 F.2d 1028 (CCA 4th 1932).

[5] Sec. 42(a), Internal Revenue Code of 1939, 26 U.S.C. 1952 ed. 41; Sec. 451(a), Internal Revenue Code of 1954; Sec. 39.42-1, Regulations 118.

Case v. Commissioner, 103 F.2d 283 (1939) the Ninth Circuit decisively rejected the Government's argument that a controlling stockholder or even one with impressive contract rights can be taxed on assets belonging to a corporation in the process of liquidation prior to the time they are actually distributed to him.

Case and one Peckham, except for directors' qualifying shares, owned all of the stock of an Idaho corporation engaged in the furniture business known as "Peckham & Case." Peckham owned 103 shares and Case owned 85. Desiring to separate the business, a contract was executed providing that 85/188ths of the assets of Peckham & Case would be transferred to a new corporation known as "Case Furniture Company" in exchange for its outstanding stock and that thereafter Peckham & Case would transfer such shares to Mr. Case in exchange for his shares in the old corporation. Reorganization was effected during 1928, substantially as provided, with one important exception, *i.e.* Peckham & Case did not actually transfer its shares of the Case Company to Mr. Case until 1931. The Commissioner and the Tax Court held that in 1928 Mr. Case realized a taxable profit measured by the excess of the fair market value of the Case Company stock over the cost basis of his shares in Peckham & Case. The taxpayer appealed, claiming that his profit from this exchange was not realized until 1931 when the shares of Case Company stock were actually delivered to him.

This Circuit, adhering to the principles just discussed, reversed the Tax Court in an opinion by Judge Stephens, holding at page 287:

"It is elemental in income tax law that a gain is

not taxable until it is realized. The argument of the taxpayer is that he realized no gain in 1928, since the actual stock certificates were not exchanged until 1931.

"The Board of Tax Appeals based its decision that the gain was realized in 1928 on the fact that the taxpayer had a specifically enforceable contract in that year under which he could have compelled the Peckham-Case Company to turn over the Case Furniture Company stock to him.... It is therefore argued that the taxpayer owned the beneficial interest in the Case Furniture Company stock, and that the fact that the stock certificates did not pass between him and the Peckham-Case Company until 1931 is not controlling.

* * *

"We do not think it can properly be said that there was a constructive receipt by the taxpayer of the Case Furniture Company stock during that year. It should be remembered that the taxpayer is being taxed on the exchange of his Peckham-Case Company stock for stock of the new corporation, Case Furniture Company. We have held that this is in the nature of a distribution in partial liquidation of Peckham-Case Company. However, the fact that Peckham-Case Company may have been obligated to make this exchange does not mean that at that point it was taxable to the taxpayer."

In line with the holding of this circuit, other circuits, as well as the Tax Court and its predecessor, the Board of Tax Appeals, have generally held in corporate liquidations that gain is neither taxable nor loss deductible until the assets are actually distributed to the stockholder. This result naturally follows from the fact that so long as assets are retained by the corporation they

are first subject to its debts and only when they are distributed do they become the property of the stockholder. Gain is taxable to the extent of such excess as soon as the taxpayer receives an amount in liquidation in excess of the cost basis of his shares. A loss, however, may not be claimed until the liquidation is fully completed, *Northwest Bancorporation v. Commissioner,* 88 F.2d 293 (CCA 8th, 1937); *Dresser v. United States,* 55 F.2d 499 (Ct. Cl. 1932).[6]

Where an individual purchases the outstanding stock of a corporation and proceeds to liquidate that corporation by a series of distributions occurring in separate taxable years, it is impossible to allocate the price paid for the stock between the varied assets of the corporation with the precision necessary to report the profit or loss realized as result of the distribution of each asset. For example, a corporation owns land, buildings, inventory, trucks, good will, trade marks and other assets. It is impossible from the purchase of stock to say that the purchaser paid any specific price for each of these assets.

Because of this factor it has long been the established rule in reporting the gain from successive corporate distributions in liquidation that the present market value of each asset distributed is applied against the total cost basis to the stockholder of his stock. After

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[6] See also: *G. Harold Earle v. Commissioner*, T.C.M. 1945 No. 281; *George Mackubin v. Commissioner*, T.C.M. 1948 No. 072; *Mrs. Grant Smith v. Commissioner*, 26 B.T.A. 1178 (1932); *Kirby v. Commissioner*, 35 B.T.A. 578 (1937); *Rex Brugh v. Commissioner*, 32 B.T.A. 898 (1935); *Harkness v. Commissioner*, 31 B.T.A. 1100 (1935); *Kell v. Commissioner*, 31 B.T.A. 212 (1934); *S. D. Sutliff v. Commissioner*, 4 B.T.A. 1068 (1926); and General Counsel Memorandum Opinion, No. 14207; Cumulative Bulletin XIV-1 at page 68 (1934).

such cost basis has been recovered the value of all property thereafter received by way of further distribution is 100% gain. *Letts. v. Commissioner,* 30 B.T.A. 800, Affirmed 84 F.2d 760 (CCA 9th 1936); *Westover v. Smith,* 173 F.2d 90 (CA 9th 1949); *Word Supply Co. v. Commissioner,* 41 B.T.A. 965 (1940); *Alvina Ludorff et al. v. Commissioner,* 40 B.T.A. 32 (1939); *Florence M. Quinn v. Commissioner,* 35 B.T.A. 412 (1937). This rule appears in most of the recognized tax services and texts.[7]

The Trial Court concluded on the basis of the foregoing authorities that "where several distributions are made in the process of completely liquidating a corporation the distributions received are first applied to reduce the cost basis of the stock and capital gain is only realized when the amount of the liquidating dividends exceed the costs basis" (R. 27). The Trial Court further concluded "it appears to be the general rule that such gain is only realized and recognized when it is actually received by the shareholder" (R. 27). Applying these rules to the facts the Trial Court held that the final distributions totaling $102,861.66 which Mattison received between May and November 1953 from the complete liquidation of the Westcott Oil Company were taxable to him in 1953 and not in 1952 as the Government contends (R. 46).

In their appeal the Government does not dispute that the Trial Judge correctly stated the general rules governing the taxation of successive distributions in the

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[7] Prentice-Hall—Federal Taxes, Sec. 9195 A; Commerce Clearing House, Inc., Standard Federal Tax Reporter Sec. 2403; Mertens, Law of Federal Income Taxation, Sec. 9.86.

liquidation of a corporation (App. Br. p. 13). Nor does the Government dispute that the result reached by the Trial Court would follow from the application of these established rules to the facts.

The Government urges upon appeal as it did upon the Trial Court that an exception to these general rules is required by the following cases: *Commissioner v. Ashland Oil & Refining Company,* 99 F.2d 588 (CCA 6th, 1938); *Kimbell-Diamond Milling Company v. Commissioner,* 14 T.C. 74, affirmed per curiam 187 F.2d 718 (CA 5th 1951); *Kanawha Gas and Utilities Company v. Commissioner,* 214 F.2d 685 (CA 5th 1955); *Koppers Coal Co. v. Commissioner,* 6 T.C. 1209; *Cullen v. Commissioner,* 14 T.C. 368; *Snively v. Commissioner,* 19 T.C. 850; and *Montana Utilities Company v. Commissioner,* 25 T.C. 408 (App. Br. pp. 13 and 14). To this contention Appellees take earnest exception.

2. The cases cited in Appellant's Brief do not upon the facts of this case require that any exception be made to the established rules, statutes and regulations governing the taxation of gains from corporate liquidations

The Government appeal is predicated upon the proposition that the cases just cited (p. 13) establish the rule "that a purchase of corporate stock for the purpose of acquiring the corporate assets through liquidation of the corporation is to be treated as a purchase of the corporate assets," and that the Trial Court erred in not applying this rule to the facts as found (App. B, p. 13). With this statement Appellees disagree completely. Inasmuch as the Government contends that the Trial Court erred in interpreting the holding of these cases, let us

examine them for the purpose of determining just what rule is established in these cases and to what factual situations it has been applied.

The first case upon which the Government relies as requiring reversal of the Trial Court is *Commissioner v. Ashland Oil and Refining Company, supra.* Ashland's predecessor, Swiss Oil Corporation, had for several years been negotiating with Union Gas & Oil Company for the purchase of certain oil producing properties which were essential to the operation of Swiss (there were no negotiations by Mattison or anyone else with the selling stockholders for the purpose of purchasing assets, nor did Mattison have any specific interest in the physical assets of the Westcott Oil Company). Following these negotiations Swiss entered into a curious contract with the stockholders of Union, solely for the purpose of acquiring the aforementioned assets. Under this contract, Swiss, it is true, agreed to purchase the outstanding stock of Union. However, the contract provided that the sale of stock did not carry with it the inventory, money, notes, accounts receivable or credits of Union and that all its liquid and intangible assets would be distributed to the old stockholders of Union in proportion to their holdings. In other words, nothing but the specific oil properties in which Swiss was interested passed upon the purchase of Union stock. (Here Mattison acquired the entire bundle of rights which go with an ordinary purchase of stock without any reservations or restrictions whatever.) This remarkable stock purchase contract further provided that the stockholders of Union were to pay all the known liabilities of Union and were to indemnify Swiss against all future claims which

might be made against Union. (There was no such reservation in Mattison's purchase of the stock of Wescott Oil Company. He assumed all the liabilities of the corporation, both known and unknown.) After Swiss acquired the "stock" of Union it dissolved Union and incorporated the oil properties it so acquired into its own operations. (Mattison did not retain any of the physical assets of the Westcott Oil Company.) Ashland, the successor to Swiss, for purposes of depletion claimed as its cost basis for these oil properties the price it had paid for the "stock" of Union. The Commissioner contended that since these assets had been acquired as result of the tax free liquidation of a subsidiary, Ashland could claim only the cost basis of these assets on the books of Union which was a very substantially smaller amount. (The present case does not involve the same question.) The Tax Court held in favor of the Commissioner.

The Court of Appeals for the Sixth Circuit upon an appeal by Ashland concluded that this hybrid contract was more in the nature of a sale of properties than a sale of stock and that for purposes of depletion Ashland could use the price it paid for the "stock" of Union. In so holding the Court stated, at page 591:

> "It seems clear that the transaction, though in form a purchase of stock, was in substance a purchase of the oil and gas leases belonging to Union. They could not otherwise be acquired. The reservation by the Union stockholders of cash, oil, notes, accounts, credits and securities clearly indicates that all that Union stockholders were selling and all that Swiss (predecessor of Ashland) was buying were the oil and gas leases. The unused material and equipment on hand and in storage on the prop-

erties would be useful in operations, but they likewise were reserved to be subjects for future barter apart from the stock. The Union stockholders were to pay all taxes and other obligations incurred prior to the initial payment, and to indemnitfy Swiss against any claims either in tort or upon contract that might accrue against Union prior to the date of the cash payment. In all essential respects this agreement segregated the oil and gas properties from all of the other assets of Union and freed them from accrued liability.''

None of the factors which were determinative in the *Ashland* case are here present. Mattison, as the Trial Court found, made a simple purchase of stock (R. 44).

Three other opinions of United States Circuit Courts of Appeal are briefly mentioned in Appellant's brief at page 24. They are *Tulsa Tribune Co. v. Commissioner,* 58 F.2d 937 (CCA 10th 1932); *Ahles Realty Corp. v. Commissioner,* 71 F.2d 150 (CCA 2nd 1934) and *Mather v. Commissioner,* 149 F.2d 393 (CCA 6th 1945). These cases add little to *Ashland Oil Co., supra,* and are cited apparently as additional authorities for the general proposition that substance governs over form and closely related transactions should be viewed as a whole. With these general statements Appellees have no dispute.

The ''well established rule'' which the Government claims requires reversal of the Trial Court is known in the tax field as the ''Kimbell-Diamond rule,'' deriving its name from the decision of the Tax Court in *Kimbell-Diamond Milling Co. v. Commissioner,* 14 T.C. 74. Its authority rests upon several decisions of the Tax Court and upon several decisions of the United States Court

of Appeals for the Fifth Circuit.[8] Insofar as we have been able to find, this rule has never been applied by this circuit. The rule has already injected much confusion into the tax law, with the Government alternatively espousing[9] but more frequently opposing its application.[10] It is by no means clear just what is the Kimbell-Diamond rule.

To define the so-called "Kimbell-Diamond rule," it is, as usual, more profitable to examine what the Tax Court did rather than to give undue weight to the language by which the end result in the decided cases was achieved. It might also be helpful to recount the economic background of the *Kimbell-Diamond* cases.

The economy has for some years been in an inflationary spiral. Many corporations owned depreciable physical assets having market values far in excess of their book basis. Other business organizations, desiring to acquire these physical properties for integration into their own activities were frequently forced to buy the stock of their corporate owners in order to acquire them.

Almost invariably the corporation whose stock was to be so acquired was stripped down to the desired physical assets prior to the sale of its stock. Upon acquisition of the stock the properties were promptly integrated by

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[8] *Kimbell-Diamond Milling Co. v. Commissioner, supra; Kanawha Gas and Utilities Co. v. Commissioner, supra; Snively v. Commissioner, supra.*

[9] *Kimbell-Diamond Milling Co. v. Commissioner, supra; Cullen v. Commissioner, supra; John Simmons Co. v. Commissioner,* 25 T.C. 635.

[10] *Ashland Oil and Refining Co. v. Commissioner, supra; H. B. Snively v. Commissioner, supra; Koppers Coal Co. v. Commissioner, supra; Kanawha Gas and Utilities v. Commissioner, supra; Trianon Hotel Co. v. Commissioner,* 30 T.C. 156 (1958).

one of several means into the operations of the acquiring corporation. The Commissioner usually contended that under the corporate adjustment provisions of the 1939 Code[11] the acquiring corporation could claim as its basis for depreciation and depletion only the basis of these assets on the books of the old corporation. The taxpayers claimed that as a practical matter they had purchased the stock of the old corporation solely for the purpose of acquiring these properties and therefore their true economic cost was the price they paid for the stock.

With this background let us consider *Koppers Coal Co. v. Commissioner,* 6 T.C. 1209, which is sometimes considered the forerunner of Kimbell-Diamond. Actually *Koppers Coal, supra,* is far more closely related to *Ashland Oil, supra.* The predecessor of Koppers, Massachusetts Gas, had sought by negotiations extending over a number of years to acquire for use in its own operations certain coal properties owned by three corporations. These negotiations proceeded to the point that formal contracts were drafted for the purchase of these properties. At the last moment the selling corporations countered with a proposal to sell their stock to Massachusetts. The selling corporations were stripped to the coal mining properties which were desired by Massachusetts and after being so stripped their stock was purchased by Massachusetts for $7,-600,000.00. Unfortunately for Massachusetts these coal properties were carried on the books of the old corpora-

[11]This inequitable situation has largely been remedied by Sec. 334(b)(2)(B) of the 1954 Code.

tions at only $3,525,000.00. Koppers, the successor of Massachusetts, by a series of mergers and liquidations acquired these coal properties and integrated them into its own operations. Koppers used as its basis for claiming depletion its cost of the stock of the old corporations of $7,600,000.00. The Commissioner asserted that these properties had been acquired as result of the liquidation of subsidiaries and that the proper basis to Koppers was the remaining basis of these assets on the books of the liquidated corporations, or $3,525,000.00. Koppers contested this determination in the Tax Court relying upon *Ashland Oil, supra.* The Commissioner, as he had done in Ashland Oil, vigorously opposed application of the *Ashland* principles. However, the Tax Court held in favor of Koppers in an opinion which states in part at pages 1217 and 1219:

> "Petitioner argues that its predecessor, Massachusetts Gas Companies, at no time had planned to invest in the stock of the six West Virginia companies and that its sole purpose was to acquire the physical coal properties and leases belonging to those companies and to place the ownership of these properties in a wholly owned subsidiary organized by it to operate them.
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> * * *
>
> "In the present case the facts supporting the position of the petitioner go far beyond those relied on by petitioner in *Commissioner v. Ashland Oil & Refining Co., supra.* Here it is conclusively established that the original intention of the petitioner was to acquire only the physical properties of the six coal companies. And the conditions of the contract under which the stock was acquired, together with the action of petitioner subsequent to its ac-

> quisition, compel the conclusion that the original plan was unchanged. Thus, we see that, although the stock of the six corporations was acquired, these corporations were first stripped of all their properties except the physical assets desired by the purchaser. Not only was this done, but the selling stockholders assumed all corporate liabilities of every kind arising through anything transpiring prior to the sale."

As in the *Ashland* case, the Tax Court emphasized that the sole purpose of the stock purchase was to acquire specific physical properties and to use those properties in the business of the acquiring corporation and that the so-called purchase of stock was a sham. None of these factors are here present.

The leading case is, of course, *Kimbell-Diamond Milling Co. v. Commissioner,* 14 T.C. 74. This case attracted wide attention and gave its name to the rule here under discussion for two reasons. The first reason is that in *Kimbell-Diamond* the Tax Court went somewhat beyond *Ashland Oil, supra.* The second reason is that the Government, after vigorously opposing application of the integrated transaction doctrine to corporate liquidations and reorganization base problems for many years, found it to its advantage in this unusual case to espouse it.

The plant of the Kimbell-Diamond Milling Company was completely destroyed by fire. The loss being covered by insurance, Kimbell-Diamond set out to buy or build another plant. By fortunate circumstances a plant belonging to Whaley Mill & Elevator Company adapted for use by Kimbell-Diamond was located. The opera-

tions of Whaley did not appear to have been particualrly successful. Whaley was willing to sell. By a resolution dated December 26, 1942 the board of directors of Kimbell-Diamond, after reciting the urgent need to replace its mill, the availability of the Whaley plant and its suitability for use by Kimbell-Diamond, authorized purchase of the outstanding stock of Whaley for $210,-000.00. Immediately after this purchase Whaley was liquidated and operation of the mill taken over by Kimbell-Diamond.

The man bites dog feature of this case arises from the fact the book value of the mill so acquired was $314,-715.69. Since the funds Kimbell-Diamond used to purchase the stock had been in part an insurance windfall, the cost to it of these shares was only approximately $139,000.00. Kimbell-Diamond, in reliance upon the general rule that the liquidation of a subsidiary is not a taxable event, claimed as its basis for depreciation and other purposes the basis of the mill on Whaley's books. The Commissioner, after opposing the idea for many years, found it to its advantage to claim that the proper basis was the actual cost to Kimbell-Diamond of the stock it had purchased solely in order to acquire the mill. The taxpayer contested this determination in the Tax Court which held in favor of the Commissioner, stating, at page 80:

> "It is inescapable from petitioner's minutes set out above and from the 'agreement and program of complete liquidation' entered into between petitioner and Whaley that the only intention petitioner ever had was to acquire Whaley's assets."

It is important to observe that when the Tax Court

speaks of "assets" and the singleness of Kimbell-Diamond's purpose in acquiring "assets," the reference is to a specific physical property and not assets in the general sense. It is also important to note that this property was incorporated in the business of the acquiring corporation. The Tax Court also considered the transaction as essentially the purchase of assets for only the limited purpose of arriving at a proper base for depreciation. *Kimbell-Diamond* is by no means authority for the broad statement of the rule made in the Government's brief.

The next case cited by the Government is that of *Ruth and Charles Cullen v. Commissioner,* 14 T.C. 368. Since 1921 Charles Cullen had engaged in the business of manufacturing artificial limbs. After 1931 this business was conducted by Charles C. Cullen & Co., a corporation, Cullen being one of four stockholders and owning one-quarter of the stock. Friction arose between the stockholdesr with the result that in 1943 Cullen purchased the stock of the other stockholders for approximately $31,000.00. On the same day he acquired the stock he dissolved the corporation, distributed the assets to himself and thereafter operated the business as a sole proprietorship. The assets of the corporation had a fair market value at the time of such distribution amounting to only approximately $23,000.00. Cullen claimed a loss on his 1943 return in the amount of approximately $8,000.00, representing the difference between the cost of his shares and the fair market value of the assets distributed to him. The Commissioner disallowed this loss on the ground that Cullen purchased a going concern having good will in addition to physical assets.

Cullen contested the Commissioner's determination in the Tax Court. The Tax Court disallowed the loss. However, in so doing it rested its decision, because of uncertainty as to whether the good will belonged to Cullen or the corporation, not upon the grounds urged by the Government but upon a somewhat curious application of the Kimbell-Diamond rule. The opinion of the Tax Court states in part, at page 373:

> "The petitioner knew the value of the corporation's assets before he offered to buy the remaining stock. . . . The petitioner's purpose was not to buy their stock as such. It was to buy up the business and the right to operate it as his own without interference from the former majority stockholders and without obligation to continue paying to them what he regarded as more than their rightful share of the earnings of the business. . . . Petitioner's purpose in buying the stock was to liquidate the corporation so that he could operate the business as a sole proprietorship. The several steps employed in carrying out that purpose must be regarded as a single transaction for tax purposes.
>
> "The petitioner paid more than the book value or fair market value of the assets in order to purchase the stock without delay and without increasing the already present strain on the personal relations of the stockholders. After acquiring the stock and dissolving the corporation pursuant to his plan, he had neither more nor less than he had paid for."

The difficulty we have in applying the Kimbell-Diamond doctrine to the *Cullen* case is that Cullen's purpose in purchasing stock was not the acquistion of assets, but rather to get the other stockholders out of his hair. However, again we observe Cullen utilized the

property acquired in his own business. It seems that what the Tax Court really said is that Cullen acquired a going business, the value of which he well knew and that after liquidation he had no more nor no less than that for which he had bargained. The result seems reasonable.

In *H. B. Snively v. Commissioner,* 19 T.C. 850, the Tax Court squarely faced the necessity for prescribing definite limits to the Kimbell-Diamond rule and as a side issue faced the other side of the Cullen coin. These two interesting facets of the *Snively* case can best be dealt with separately.

Early in 1943 Snively solely and expressly for the purpose of acquiring an orange grove purchased the outstanding stock of Meloso, its corporate owner. For several reasons Snively was unable to effect a dissolution of Meloso until December of 1943. Before the dissolution of Meloso was effected the 1943 orange crop was sold. Snively reported the sizeable proceeds from this sale as personal income, 1943 being an excess profits tax year. The Commissioner determined that this income belonged to Meloso and proposed assessment of very substantial corporate excess profit taxes. Snively contested this determination in the Tax Court.

In the Tax Court Snively took exactly the same position the Government takes here, arguing on the basis of *Ashland Oil, supra,* and *Kimbell-Diamond, supra,* that there is "an established rule that a purchase of corporate stock for the purpose of acquiring corporate assets through liquidation of the corporation is to be treated as a purchase of the corporate assets." Logically, of

course, if Snively's purchase of the stock of Meloso is to be treated for every purpose as a purchase of assets as the Government brief contends, the corporate entity would be disregarded and the proceeds from the sale of the 1943 crop would, of course, have been income to Snively. The Tax Court ruled in favor of the Commissioner, making it clear that a purchase of stock for the purpose of acquiring assets through liquidation will be considered as a purchase of assets for only quite limited purposes. The opinion states at page 858:

> "The petitioner argues, in effect, that this purchase of the stock and the succeeding moves to liquidate Meloso in some way incapacitated Meloso from earning, receiving, or being taxable with income from and after the date of the stock purchase. His main reliance is on *Commissioner v. Ashland Oil & R. Co., supra*. . . . We do not understand that case, which will be discussed later, to stand for such a proposition and find no merit in this argument. The stock purchase coupled with the intent to dissolve the corporation and the taking of some steps to that end, in our opinion did not *ipso facto* either destroy the existence of the corporation as a taxable entity or permit the petitioner to appropriate as his own income which would otherwise be taxable to the corporation."

Snively, urging, as does the Government here, that a purchase of stock for the purpose of acquiring assets through liquidation is tantamount to a purchase of assets, appealed the decision of the Tax Court against him to the United States Court of Appeals for the Fifth Circuit. The Fifth Circuit, 219 F.2d 266 (1955) affirmed the Tax Court, holding at page 268:

> "When petitioner determined to acquire the

> stock of Meloso in order to get the grove on liquidation he was, of course, aware of the technical and substantial differences between the acquisition of the stock and the acquistion of the property. He now stands in the position of asserting that so far as relates to the sale of the bulk of the 1943 crop there was no difference. . . . We hold the income was that of Meloso. . . . "

The decisions of both the Tax Court and the Fifth Circuit in the *Snively* case, *supra,* illustrate the dangers of so broad a statement of the Kimbell-Diamond rule as is here urged by the Government and the necessity for confining the rule to the limited situations in which it has been applied.

The incidental issue in the *Snively* case, *supra,* also involved the Kimbell-Diamond rule. Snively, as has been mentioned, undertook negotiations with the stockholders of Meloso, a Florida corporation, for the purpose of acquiring a citrus grove owned by Meloso. Because of tax considerations the stockholders refused to sell the grove but offered to sell Snively their stock for $110,000.00. In March of 1943 Snively purchased the outstanding stock of Meloso. Necessary delays prevented the liquidation of Meloso until December 31, 1943. The fair market value of the grove at the time it was conveyed to Snively upon liquidation was slightly in excess of the cost basis of his shares. Snively first reported this gain as a long-term capital gain. The Commissioner claimed it was a short-term capital gain and later the taxpayer claimed no gain at all had been realized. On this point the Tax Court held in favor of Snively.

It is important to observe (1) that Snively's sole interest was a specific physical property, and (2) that Snively used this property in his own business.

Kanawha Gas and Utilities Co. v. Commissioner, 214 F.2d 685 (CA 5th, 1954) cited by the Government as authority for a rule of the breadth urged by the Government, is almost identical with *Ashland Oil, supra.* A predecessor of Kanawha, Anderson Development Company, was interested in 132 gas wells located in Lincoln County, West Virginia, owned by eight corporations. Anderson retained geologists and engineers to survey these gas properties and as a result of such survey entered into negotiations for their purchase. The corporations owning them, for tax considerations, refused to sell these properties but offered to sell their outstanding shares to Anderson. Prior to the sale of their shares to Anderson these corporations were stripped of their other assets and liabilities, leaving only the specific oil and gas properties desired by Anderson. Immediately after purchase of the outstanding stock of these stripped companies, Kanawha, the assignee of Anderson, proceeded to integrate them into its operations. These transactions were accomplished in the summer of 1929. However, legal title to these properties remained in the eight corporations until December, 1929. For the year 1929 Kanawha and these corporations filed consolidated returns. In 1941 and 1942 a substantial portion of these gas properties was sold. Kanawha used as its basis for computing its gain the cost to it of the stock of the eight stripped corporations. The Commissioner insisted their base was their book value in the old corporations.

Kanawha appealed the Commissioner's determination to the Tax Court. The Tax Court, in 19 T.C. 1023, held in favor of the Commissioner, distinguishing *Kimbell-Diamond, supra,* by the fact Kanawha and these eight corporations had filed consolidated returns for 1929.

From this adverse decision Kanawha appealed to the United States Court of Appeals for the Fifth Circuit. The Fifth Circuit, 214 Fed. 685, reversed the Tax Court, holding that the filing of consolidated returns was insufficient reason for distinguishing the facts from the *Kimbell-Diamond* case, *supra,* and pointing out that the facts are almost identical with those of *Ashland Oil, supra.* The *Kanawha* case presents, of course, all the classic factors requisite for application of the Kimbell-Diamond rule, *i.e.*:

1. A sole purpose of acquiring specific physical properties;

2. Integration of the acquired properties into the business operations of the acquiring corporation; and

3. Using the true economic cost of such assets as their base for tax purposes.

The remaining case cited in the Government's brief as authority for the broad statement of the Kimbell-Diamond rule is *Montana-Dakota Securities Co. v. Commissioner,* 25 T.C. 408. This case is almost identical with Kimbell - Diamond. Montana - Dakota's predecessors were interested in acquiring certain public utility properties in the Dakotas owned by Dakota Public Service Company, a subsidiary of United Public Utilities Company, a holding company. Dakota-Montana's predeces-

sors, knowing that United had been ordered by the Securities and Exchange Commission to divest itself of these properties, entered into negotiations for their purchase. United would not agree to a sale of assets by Dakota. Therefore, Montana-Dakota's predecessor agreed to purchase the stock of Dakota with the understanding that after such purchase Dakota would be liquidated and the properties consolidated into the operations of Montana-Dakota. After securing the necessary approval of various regulatory agencies, Montana-Dakota did purchase the stock of Dakota, liquidated Dakota and integrated such properties into its operations. Montana-Dakota used as the basis for depreciation the amount it paid for the stock of Dakota. The Commissioner contended these transactions came within the ambit of the non taxable reorganization provisions of the Code and that their proper basis was their old book value. Montana-Dakota contested this determination of the Commissioner. The Tax Court ruled in favor of Montana-Dakota, stating at page 415:

> "It is quite clear from the record that, whether petitioner negotiated specifically for the assets of the two corporations or not, its primary, in fact its sole purpose, was to acquire the corporate assets through the purchase of the stock and the immediate liquidation of the corporations, to the end that it might integrate the properties into its directly owned operating system."

All the cases cited in the Government's brief present fact patterns which are quite different from the one now before this Court. In practically every one of these cases there were prior negotiations between the purchaser and the selling stockholders looking toward the purchase

of specific physical properties. In all of these cases the purchasers' sole purpose was to acquire specific physical properties. In all of these cases the properties acquired were integrated into the business of the purchaser. In almost all of these cases the corporation whose stock was acquired was, prior to the sale of its stock, stripped so that, actually, the purchaser acquired only these specific physical properties. Almost without exception, the only question presented was whether the basis of these properties in the hands of the purchaser was their value on the books of the old corporation or the price the purchaser actually paid in order to acquire them. In summary all the cases cited by the Government have really held is that where the stock of a corporation is purchased solely for the purpose of acquiring specific physical properties and such assets are thereafter distributed to the purchaser through liquidation for integration into the business of the purchaser, the basis of such properties in the hands of the purchaser is the price paid for such stock.

These cases are by no means authority for the proposition advanced by the Government that every purchase of the outstanding stock of a corporation followed by liquidation is to be treated for all purposes as though the transaction were a purchase of assets. There are, it would appear, two basic fallacies in the Government's statement of the Kimbell-Diamond rule. The first is that in order for the rule to be applicable a great deal more is required than a general interest in the assets of the corporation. The second fallacy is the assertion the purchase of stock should be treated for all purposes as a purchase of assets. The cases cited have held that for

only certain limited purposes the purchase of stock will be treated as a purchase of assets. Indeed the Fifth Circuit makes amply clear in the *Snively* case, *supra,* for most purposes such transactions will be treated as a purchase of stock and a liquidation.

The Tax Court in three recent cases not mentioned in the Government's brief has gone to considerable effort to point out that the Kimbell-Diamond rule must be strictly limited to the facts of the cases heretofore decided and made it quite clear that these cases are in no wise authority for so broad a statement of the rule as is urged upon this Court by the Government.

The first such recent case pointing out the narrow limits of the Kimbell-Diamond rule is *John Simmons Co. v. Commissioner,* 25 T.C. 635. John Simmons Company, a New York corporation, had been in the plumbing supply business for many years. In about 1934 it experienced financial difficulties soon complicated by the death of Simmons, the principal stockholder. Two of the old employees resolved to buy the business and approached the corporation's bank for financial assistance in this undertaking. At the insistence of the bank a New Jersey corporation of approximately the same name was formed. As soon as the outstanding stock of the old New York company was acquired by these employees a merger was effected in which the New Jersey corporation was the survivor. For tax purposes the surviving corporation used the value of the assets so acquired shown on the books of the old corporation, which was substantially higher than the price the employees paid for its stock. The Commissioner, relying upon

Kimbell-Diamond, supra, determined that the transaction should be treated as though the acquiring corporation had purchased assets with the result that the proper basis for these assets would be the price paid for the stock of the old corporation. The corporation contested the Commissioner's determination in the Tax Court. The Tax Court held that the Kimbell-Diamond rule was not applicable. The opinion of the Tax Court at pages 641 and 642 is especially interesting and is quoted at some length:

> "Counsel for the respondent argues that under decided cases involving similar circumstances there was here in substance a purchase by the petitioner of the assets of the New York company. He cites the cases of *Commissoner v. Ashland Oil & Refining Co., supra; Koppers Coal Co., supra; Kimbell-Diamond Milling Co., supra;* and *Kanawha Gas & Utilities Co., supra.*
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> "Our examination of the cases cited by the respondent convinces us that the prinicple enunciated therein was intended to be and should be limited to the peculiar situations disclosed by the facts in each of those cases and should not be extended to a case such as this, where the evidence establishes a wholly different origin and reason for the patterns of the transactions. In each of those cases it appeared that an existing corporation had as its primary purpose or indeed its sole purpose, the purchase of a particular asset or a group of assets of another corporation, but was forced by circumstances beyond its control to effect the acquisition through the channels of first acquiring stock and then liquidating the subsidiary. . . .
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> "Here the testimony shows that it was the desire of the individuals who were then in active conduct

of the business of the New York company to continue that business in corporate form. Neither they nor the petitioner had as their sole or primary motive the acquisition of particular assets. Neither the individuals nor the petitioner at any time negotiated for the acquisition of any of the assets of the New York company. Rather, the purpose and the negotiations were to acquire stock and thereby acquire control of the company and its business.''

The Tax Court in the recent case of *Trianon Hotel Co. v. Commissioner,* 30 T.C. 156 (1958) makes it extremely clear that the Kimbell-Diamond rule is far more limited than its statement in the Government's brief and is not to be extended beyond the specific situations to which it has already been applied. Trianon purchased all the outstanding stock of Allis, another corporation, for $2,342,925.00. Immediately upon acquiring the outstanding stock of Allis, Trianon dissolved Allis and distributed to itself the assets of Allis. These assets had a book value of $1,067,481.29. The minutes of the board of directors of Trianon authorizing the purchase of these shares set forth very plainly that the purpose of acquiring the outstanding stock of Allis was to liquidate it in order to acquire its assets. After so acquiring the assets of Allis, Trianon used as its basis for depreciation the price it had paid for the stock of Allis, or $2,342,925.00. Upon audit the Commissioner determined that these transactions constituted a tax free merger and under the applicable statutes and regulations the proper basis for such assets was their basis on the books of Allis.

In reliance upon the cases cited in the Government's brief, Trianon contested this determination of the Com-

missioner in the Tax Court. Interestingly enough the opinion of the Tax Court in favor of the Commissioner makes the same distinction concerning the applicability of the Kimbell-Diamond rule as did the Trial Court, pointing out that the necessary prerequisite to applicability of the rule is the sole and specific purpose of acquiring physical properties for integration into the business of the purchaser and that this requirement is not met where the acquisition of assets is incident to some other purpose. Since the Tax Court reached the same conclusion with respect to the Kimball-Diamond rule as did the Trial Court, the opinion of the Tax Court is quoted at some length:

> "If the petitioner is to prevail, it must be established that the purchase of Allis Corporation's stock, and the subsequent liquidation of Allis Corporation, constituted, in substance, one integrated transaction in which Trianon intended to purchase Allis Corporation's assets. See *Commissioner v. Ashland Oil & R. Co., supra; Koppers Coal Co., supra; Kimbell-Diamond Milling Co., supra; Kanawha Gas & Utilities Co. v. Commissioner, supra; Montana-Dakota Utilities Co., supra.*
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> "It is not necessary for us to review the facts and conclusions of the above-cited cases. In each case it appears that a corporation had as its primary purpose the purchase of the assets of another corporation, but was forced by the selling shareholders to effect the asset acquistion by first acquiring stock and then liquidating the acquired subsidiary. In the cases cited, an important factor was that the acquiring corporation had no intention of merely continuing the business of the old corporation in a new corporate form. This court has

held that the principles enunciated by the foregoing cases *do not apply when the acquiring corporation does not intend to integrate the acquired assets into its own operations.* (Emphasis supplied) *John Simmons Company,* 25 T.C. 635.

"Upon a careful examination of the entire record, we are compelled to conclude that Trianon did not have as its primary purpose in purchasing Allis Corporation's stock the acquisition of the assets of that corporation. It is true, as Trianon contends, that the minutes of its board of directors' meeting on December 5, 1950, authorized the purchase of Allis Corporation's stock and clearly set forth an intent to subsequently liquidate Allis Corporation to acquire the assets. It is true also that Trianon did not deviate from such expressed intention. . . .

" . . . both Woolf and Shanberg (directors of both corporations) expressed a desire to convert their stock into cash or securities in order to put their estates into a more liquid condition. Woolf, in his testimony, agreed that he wished to get his estate more liquid so that it could meet possible inheritance and estate tax liabilities. . . . Woolf also stated that Shanberg was concerned about the liquidity of his estate.

* * *

"The above mentioned facts create a strong inference that Trianon's board of directors considered purchasing Allis Corporation's stock in order to convert such stock into liquid assets, without depriving the majority shareholders of their control over the operations of the latter corporation. Such an intention suggests that the purchase of stock was not to acquire assets, but to supply certain of Allis Corporation's majority shareholders

with readily available funds which would not be depleted by a dividends tax.

"In making our determination, however, we rely mainly on the conclusion that Trianon did not acquire a group of assets when it purchased Allis Corporation's stock and subsequently liquidated that corporation, but a separate, going business."

Thus, despite clear evidence of an intention to acquire assets through the purchase of Allis' stock and liquidation the Tax Court held the Kimbell-Diamond rule is not applicable for three reasons: (1) The motive for the transactions was not solely to acquire specific physical properties;[12] (2) by the purchase of stock the acquiring corporation secured not naked physical assets but a going business;[13] (3) the purchaser did not incorporate the acquired assets into its own business.[14]

The most recent case decided by the Tax Court refuting the rule as here urged by the Government is *Conte Equipment Corp. v. Commissioner,* T.C.M. 1958, No. 171. In this case the Tax Court again emphasizes that in order for the Kimbell-Diamond rule to be applicable a great deal more is required than an acquisition of the stock of a corporation in order to acquire its assets (in a general sense) and the subsequent distribution of those assets to the purchaser through liquidation.

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[12]Mattison's motive was, of course, to make a profit. The health of Westcott, his concern for the liquidity of his estate, and the concern of the stockholders as to the future of the company upon the death of Westcott were the factors motivating the sellers (R. 45, 79, 80).

[13]Mattison, through his purchase of stock, acquired a highly successful, going business (R. 33, 44).

[14]Mattison had no interest in the assets of the Westcott Oil Company except insofar as they were part of his plan to realize a profit through liquidation (R. 45).

Conte Equipment Corp., Conte Investment Company and Conte Eastwood, Inc., were separate corporations owned by members of the Conte family. On January 8, 1953, Conte Equipment purchased all the outstanding stock of the last two corporations for about $300,000.00. The principal if not only assets of Eastwood and Investment were a block of downtown real estate carried on their books at approximately $225,000.00. In March Conte concluded negotiations for the sale of these properties to a third party for $320,000.00. Investment and Eastwood were liquidated and these assets distributed to Conte, who immediately sold them at the price just mentioned. Conte reported a gain on this sale in the amount of $20,000.00, representing the excess of the price at which the properties had been sold over the cost to it of the stock acquired in order to secure them. The Commissioner, applying the liquidation of a subsidiary provisions of the Code, determined that the proper basis for this block of real estate was $225,000.00, its basis on the books of the dissolved corporations. Conte, in reliance upon the cases cited in the Government's brief, made the same argument as the Government makes here that the foregoing transactions should be treated as a purchase of assets by Conte. The Tax Court in denying relief to the taxpayer held the Kimbell-Diamond rule was not applicable because the objective for the purchase of stock and liquidation was not solely the acquisition of specific physical assets. Rather as here, the purpose was to make a profit.

In summary, it appears the Kimbell-Diamond rule is merely that where the stock of a corporation is acquired solely for the purpose of acquiring certain phys-

ical properties which are incorporated into the business of the purchaser through liquidation the basis of such properties in the hands of the purchaser shall be the cost to him of the stock he purchased in order to acquire them. No case has been cited in which the Kimbell-Diamond rule has been used as authority for disregarding the annual accounting concept, or for the purpose of avoiding application of the principle of recovery of cost in successive corporate distributions in liquidation, or for the purpose of taxing income to a cash basis taxpayer in a year other than that in which it is received. The cases cited contain no suggestion that the rule should be extended to these lengths.

The cases relied upon in the Government's brief were effectively urged upon the Trial Court in two excellent briefs filed by the Tax Division. They were cited, discussed and searchingly analyzed in the Trial Court's memorandum opinion (R. 828). After careful considation of these cases the Trial Court concluded that the Kimbell-Diamond rule is not nearly so broad as urged in the Government's brief and that to apply the Kimbell-Diamond rule to achieve the result sought by the Government in this case would require an extension of that rule very substantially beyond the decided cases and beyond the limits to which it has been confined by its originator, the Tax Court (R. 27, 28). The Trial Court declined to make this extension. In view of the later authorities this denial by the Trial Court seems extremely well founded and merits affirmation.

3. The finding of the Trial Court that Mattison in substance purchased the stock of the Westcott Oil Company and realized a profit in 1953 from its complete liquidation is essentially a finding of fact amply supported by the record

Putting aside for the moment the differences between the parties as to a proper statement of the Kimbell-Diamond rule, it is nothing more nor less than another application of the rule that substance must govern over form.[15] However, as the Trial Court points out (R. 28) in a given situation what is substance or, stated another way, whether transactions are so integrally related they should be considered as one is a question of fact.[16] This court had recent occasion to make these observations in the case of *Jacobs v. Commissioner*, 224 F. 2d 412 (1955). In this case the Tax Court found as a fact that a series of transactions effected by Jacobs were in substance the sale of land. Jacobs appealed the decision of the Tax Court against him to this Circuit. This Circuit affirmed the decision of the Tax Court in a rather brief opinion, stating at page 413:

> "Whether for tax purposes several acts constitute separate and distinct transactions or are integrated steps in a single transaction is a question of fact."[17]

In the final analysis, whether the transactions here in

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[15] *Kanawha Gas and Utilities Co. v. Commissioner, supra*, p. 691; *Kimbell-Diamond Milling Co. v. Commissioner, supra*, p. 80; *Commissioner v. Ashland Oil & R. Co., supra*, p. 59.

[16] *United States v. Cumberland Public Service Co.*, 338 U.S. 451 (1950); *Commissioner v. Court Holding Co.*, 324 US.. 331 (1945).

[17] See also: *Heller v. Commissioner*, 147 F.2d 376 (CA 9th 1954); *Houck v. Hinds*, 215 F.2d 673 (CA 10th 1954); *Kolkey v. Commissioner*, 254 F.2d 51 (CA 7th 1958); *Spirella Co. v. Commissioner*, 155 F.2d 908 (CCA2d 1946).

question are in substance a purchase of the outstanding stock of a corporation followed by the liquidation of that corporation or simply a disguised purchase of assets is a question which, if a jury had been impanelled, would have been submitted to it for a finding of fact.[18] This being true it follows that such finding of fact by the Trial Court should not be disturbed unless it is clearly erroneous.[19]

This case was decided after a trial extending about two days. Five witnesses were called by Mattison; three witnesses were called by the Government. Cross examination by the Government was extensive. Twenty-seven voluminous exhibits were received in evidence. A transcript of the record was prepared (R. 218). The matter was taken under advisement by the Trial Court (R. 217, 218). Several written briefs were submitted by both parties which the Trial Court was generous enough to term excellent (R. 27). After carefully considering the evidence the Trial Court prepared a penetrating memorandum opinion (R. 21 through 31). Later it entered detailed findings of fact (R. 31 through 47).

After carefully considering all the evidence the Trial Court found that the substance of the transactions here involved was identical with their form (R. 43). This substance was that Mattison purchased the outstanding stock of the Westcott Oil Company from the selling stockholders not because of any special interest in acquiring for himself the physical assets of the Company but because he hoped over a period of time to liquidate

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[18] *Georgia Pacific Corp. v. Commissioner*, 264 F.2d 161 (CA 5th 1959).

[19] *McCaughn v. Real Estate Title and Trust Co.*, 297 U.S. 606 (1935).

it at a profit (R. 45). The Trial Court further found that Mattison sold the operating assets of the Company in 1952 at a profit in the amount of $23,276.29 which he correctly reported in his returns of that year (R. 40); that the liquidation of the Company proceeded as promptly as was reasonable under the circumstances (R. 43) and that upon completion of this process of liquidation in 1953 Mattison received in 1953 a gain in the amount of $102,823.49, which was taxable to him in 1953. The exhibits and testimony received in evidence permit of no other conclusions.

The contracts between Mattison and the selling stockholders clearly describe the subject matter of sale as stock (Exhibits H, I). The records of the First Security Bank of Idaho clearly describe the subject matter of the transaction as a purchase and sale of stock (Exhibits W, X, Y). All the formalities incident to a sale and transfer of stock were complied with (Exihibit M, R. 43). Mattison testified he purchased stock (R. 126 through 133). Witnesses Westcott, Dollard and Eberle testified that they sold Mattison stock, not assets (R. 108, 187, 214). The selling stockholders had never negotiated with Mattison or anyone else for sale of assets (R. 70 through 112). The price for which this stock was purchased by Mattison was fixed by the selling stockholders more or less at a figure they had picked out of the air as the value of their shares plus their tax cost (R. 84 through 87). The price Mattison paid for the shares was not based upon any appraisal or evaluation of the assets and was unrelated to the assets of the Company except to the extent the price of any stock is to some degree influenced by the value of the assets behind

it (R. 76 through 113). The price at which Mattison purchased the shares in question took into account the earning history of the Company, its dividend record, its going concern value and good will (R. 112, 113).

Mattison by the purchase of these shares acquired not only the assets of the Company but all its liabilities including the liability of $310,000.00 to the First Security Bank of Idaho, known and unknown liabilities of taxes and liabilities of all future claims of every nature which might be made against the Company (R. 136, 141). Mattison acquired the cash of the Company, its inventories, accounts receivable, accounts payable. In short Mattison acquired every right and liability and every advantage and disadvantage which goes with the purchase of stock (R. 44). There were no side agreements between Mattison and the selling stockholders which would distinguish the transaction between them from an ordinary purchase of stock (R. 93, 94, 145). At the time Mattison purchased the outstanding stock of the Westcott Oil Company there was considerable uncertainty as to whether the Company could be liquidated at a profit (R. 135, 136, 157, 184). The record is quite clear that until the Company was completely liquidated Mattison had no control over its funds and made no use of those funds (R. 39, 91 through 93).

The Trial Court found that the transactions here in question were in substance a purchase of stock and a corporate liquidation and not, as the Government urges, a simple purchase and sale of operating assets concluded in 1952. In this finding of fact the Trial Court is supported by the overwhelming weight of the evidence and the finding should be affirmed.

4. Without disregarding basic statutes and rules of taxation, application of the Kimbell-Diamond rule would not achieve a result different from that reached by the Trial Court

The Government contends that Mattison in reality purchased the assets of the Westcott Oil Company from the other stockholders (Appellant's brief, pp. 13 through 25). For reasons well set forth in its memorandum opinion the Trial Court found otherwise (R. 21 through 31). As we have pointed out the Kimbell-Diamond rule is not applicable to the facts before us. However, even if we assume, *arguendo,* that the contention of the Government be true and Mattison in substance purchased the assets of the Westcott Oil Company, it by no means follows that Mattison, a cash basis taxpayer, can be taxed in 1952 upon a gain of $102,-823.49 which he never received or became entitled until May 12, 1953 or later. Certainly none of the Ashland Oil and Kimbell-Diamond cases are authority for the proposition that income may be taxed in a year other than that in which it is received.

There are some very hard, simple and undisputed facts which the Government's brief ignores and which sharply illustrate the inapplicability of the rules espoused by them to this case. During 1952 Mattison bought whatever we wish to call it, paying $1,352,-321.82. During 1952 he received from the sale of whatever we care to call it $1,379,275.18, incurring necessary expenses in the amount of $3,677.07. A certified public accountant testified during the trial that Mattison's 1952 gain on this transaction must, regardless of what the subject of the transaction might be, if accepted ac-

counting principles are followed, be computed as follows:

Received	$1,379,275.18
Expended	1,352,321.82
Gross Gain	$ 26,953.36
Expenses	3,677.07
Net Gain	$ 23,276.29

(R. 177 through 180).

This is exactly the amount reported on Mattison's return for 1952.

At the close of 1952, assuming he had spent not one cent of this gain, Mattison had only $23,276.29 more than he had when he started the year. The Government claims in all apparent sincerity that he should have paid taxes of $69,257.45 for 1952. Nowhere in the Government brief is there any suggestion as to how this could have been accomplished. This is but one of the bizarre results which would follow from not applying to the instant transaction the established rules which experience has dictated are essential in corporate liquidations.

The gymnastics of logic through which the Government asks the Court to follow them in order to achieve a result different from that reached by the Trial Court show remarkable imagination. The Government argues during the major portion of their brief that Mattison's sole purpose in the transactions now before the court was to acquire the physical assets of the Westcott Oil Company.[20]

[20] If it be true that the acquisition of physical assets was Mattison's sole purpose in purchasing the stock of the Westcott Oil Company, it follows necessarily that the entire purchase price he paid for the stock, or $1,352,321.42, was expended to acquire these assets. This leads us directly back to the result reached by the Trial Court.

Once having used the singleness of purpose argument in an effort to bring the facts within the ambit of the Kimbell-Diamond rule, the Government blithely casts it aside and argues that Mattison had two purposes in purchasing the outstanding stock of the Company. One was to acquire its physical assets. The other was to realize a profit at some future date through complete liquidation. But the Government then proceeds to rationalize that of the total amount he paid for the outstanding stock of the Westcott Oil Company Mattison paid $1,249,498.33 for the operating assets and paid $102,861.66 for the prospect of gain through eventual liquidation. This is, of course, just arithmetic sleight of hand to tax in 1952 the $102,861.66 which Mattison received between May and November of 1953. For it matters not one whit in result whether the funds he received in 1953 were added to his 1952 receipts or subtracted from his 1952 disbursements. The result is exactly the same.

The only fair inference from the evidence is that at the time Mattison purchased the remaining stock of the Westcott Oil Company there was no way of knowing that in the following year he would receive $102,861.66 or any amount upon final liquidation. There were real possibilities liquidation could have resulted in a loss (R. 136). A number of events could very easily have occurred between June 1952 and the final liquidation of the Company in 1953 which would have converted Mattison's venture into a disastrous loss (R. 136, 184). Yet if we follow the Government's rationale, Mattison incurred a tax liability of $69,257.45 from a sale of the physical assets on June 16, 1952 regardless of whether

the whole transaction resulted in a profit or loss. This is obviously untenable.

The Government admits, as it must, their position is that Mattison's 1952 taxes should be computed on the basis of "the fair market value of the other property which he received in cash or property in the following year (1953)" (App. Br. p. 15). In short the Government argues that Mattison's 1952 income tax liability must be computed on the basis of events which occurred in the middle of 1953.[21] The fact that tax liabilities for one tax period may not be determined by events occurring after the close of that period was put at rest by the Supreme Court of the United States in *Security Flour Mills v. Commissioner,* 321 U.S. 281. Security Flour Mills, a manufacturer reporting its income on the accrual basis, during the year 1953 collected from its customers certain processing taxes, the constitutionality of which tax was being contested in the courts. After termination of this litigation in favor of the millers the funds collected were returned to its customers. Most of the repayments were made in 1936 but some as late as 1937 and 1938. The Commissioner disallowed the deduction of the repayments which Security Flour Mills claimed on its 1935 returns on the grounds that these repayments were neither made nor properly accruable in that year. Security Flour Mills contested the Commissioner's determinations on the ground that while these amounts were not returned to their customers until after the close of 1935, it was necessary to take them into account in order accurately to reflect

[21]This court and most of the other circuits have decisively held that a taxpayer may not be given tax effect on distributions in liquidation until they are received (p. 11, *supra*).

1935 income. The Supreme Court of the United States in an opinion sustaining the Commissioner hewed strictly to the annual accounting concept and held that transactions must given tax effect only in the year in which they occur. The opinion of Mr. Justice Roberts state in part at pages 285 and 286:

> "But we think it was not intended to upset the well understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer.
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> * * *
>
> "This legal principle (the annual accounting concept) has often been stated and applied. The uniform result has been denial both to Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, . . . "

Probably no principle is more firmly stablished in tax law than the annual accounting concept.[22] However, the Government contends that the Trial Court erred because it refused to do exactly what these cases say may not be done, *i.e.,* account for in Mattison's 1952 taxable income funds which he did not either receive or become entitled until 1953.[23]

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[22]*United States v. Lewis,* 340 U.S. 590 (1951); *Dobson v. Commissioner,* 320 U.S. 489; and other cases cited in *Security Flour Mills, supra.*

[23]The Government's basic argument sometimes is the one Snively made

Often it is helpful in analyzing an argument to consider it in reverse. So let us assume complete liquidation of the Westcott Oil Company in 1953 resulted in a loss, could Mattison have taken this loss into account in computing his 1952 gain from the sale of physical properties? It is quite clear he could not have.

In *Roberta Pittman v. Commissioner*, 14 T.C. 449 Miss Pittman, in 1945, dissolved a wholly owned corporation, realizing a profit of approximately $21,000.00. In 1946 a tax deficiency in the amount of about $3,000.00 was assessed against the corporation. These taxes were paid in 1947 by Miss Pittman as transferee. Miss Pittman claiming credit for the $3,000.00 in taxes she paid after the close of 1945, reported her 1945 gain as $18,-000.00. The Commissioner claimed the 1945 gain was $21,000.00 and the $3,000.00 tax payment could not be taken into account until 1947 when it was made. The Tax Court held in favor of the Commissioner, pointing out that a disbursement after the close of the taxable year could not be given tax effect. See also: *Arrowsmith v. Commissoner,* 344 U.S. 6 (1952) involving the question of whether such a loss in a subsequent year is an ordinary loss or a capital loss.

As authority for disregarding Secs. 41 and 42 of the Internal Revenue Code of 1939 and the authortiies heretofore cited, the Government cites a memorandum decision of the Tax Court, *Graves v. Commissioner,* 1952 T.C.M. No. 143. The *Graves* case is not in point.

The *Graves* case does not involve a purchase of stock,

in *Snively v. Commissioner, supra, i.e.,* that Westcott Oil Company should be disregarded as a corporate entity. Since the Company functioned as a *de facto* and *de jure* corporation until June 19, 1953 (R. 45) this argument does not seem tenable.

a liquidation or even the Kimbell-Diamond rule. Graves did not buy the stock of a corporation and acquire its properties through liquidation. Graves merely purchased an assorted group of properties including inventories, machinery and accounts receivable. Graves individually acquired title to all these properties at the time of his purchase. All the Tax Court held is that the $250,000.00 which Graves paid for these properties should be allocated between them on a different basis than Graves had done and that in making this allocation some account could be taken of the prices at which these properties were sold the following year.

The basic difference between the *Graves* case and the facts here is that in 1952 Mattison did not have title to or any ripened legal right to the property which he received the following year. These assets until May 13, 1953 belonged to the corporation and were subject to its debts. Obviously, no allocation of cost can be made to property until the purchaser becomes enitled to the property. The only possible circumstance under which the *Graves* case could be considered in point is for this Court to do exactly what the Fifth Circuit refused to do in the *Snively* case, *supra,* and what this Circuit refused to do in *Case v. Commissioner, supra, i.e.* disregard Westcott Oil Company as a corporate entity and consider Mattison as individually owning all the assets of the Company prior to the time they are distributed to him.

The *Graves* case is certainly not authority for using allocation of purchase price as a device for taxing income prior to its receipt which is what the Government

seeks to do here. The entire receipts from Graves' sales property in 1943 were not taxed to him in 1942 as the Government would do here. These sales were only used as evidence that these properties had some value in 1942. In the *Graves* case most of Graves' income was held to have been realized in 1943.

In the *Graves* case the Tax Court found it possible to make an allocation as between the cost of the various assets purchase as a lot. However, where a conglomerate lot of assets is purchased and it is difficult or impossible to allocate the purchase price as between the various items purchased, the courts have frequently, even in the case of straight purchases of physical assets, applied the recovery of cost principle. A typical illustration is *United Mercantile Agencies, Inc. v. Commissioner,* 23 T.C. 1105. United purchased a considerable quantity of notes, judgments and other assets from insolvent banks. No attempt was made at the time of purchase to allocate the amounts paid for specific items. Receipts were treated as return of capital until the total amount paid to the bank had been recovered. Thereafter all proceeds were treated as gain. The Commissioner insisted than an allocation of cost must be made and that the profit from the sale of each item be computed and reported in its year of sale. The Tax Court held against the Commissioner.

Even if the transaction before this court were a simple purchase of assets, which the Trial Court found it was not, there is no evidence in this record from which the Trial Court could have found, as the Government contends, that $102,823.49 of the amount which Mattison paid for the remainder of the stock of the Westcott

Oil Company was paid for the prospect of profit upon complete liquidation.

The only fair inference from the record is that any reasonable approximation of the eventual profit which it would be possible to realize upon complete liquidation of the Westcott Oil Company was impossible at the time Mattison purchased the remainder of its stock. Indeed at that time complete liquidation seemed more of a liability than an asset (R. 184).

VI. CONCLUSION

The cases relied upon by the Government all involve situations where the ordinary rules applicable to corporate adjustments would work an injustice, usually to the taxpayer, but in some instances to the Government. In most situations it was the simple fact a taxpayer could not claim depreciation on the price he had actually paid to acquire certain physical properties.

The Trial Court found as matters of ultimate fact that Mattison had in substance purchased the stock of the Westcott Oil Company and realized profit in 1953 from complete liquidation of the Company.

Application of the Kimbell-Diamond rule to these facts in order to achieve the result sought by the Government the Trial Court concluded would require an extension of that rule far beyond the limits to which it had been applied in the decided cases (R. 28). This extension of the Kimbell-Diamond rule beyond the decided cases the Trial Court refused to make. This being so, the Trial Court concluded that the ordinary statutes, Commissioner's regulations and cases relative to cor-

porate liquidations were applicable. Counsel for Appellees earnestly urge this circuit court not to extend the Kimbell-Diamond rule beyond its present limits and point out that an extension to the length urged by the Government would result in overruling long established precedents of this and other courts, disregarding basic Code provisions, and would in most instances result in the application to corporation dissolutions of rules quite unsuited for the determination of taxable income.

In every respect the judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

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